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In the Supreme Court of the United States

OCTOBER TERM, 1940

THE HYGIENIC PRODUCTS COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 12–18) is reported at 37 B. T. A. 202. The opinion of the Circuit Court of Appeals for the Sixth Circuit (R. 31–33) is reported at 111 F. (2d) 330.

JURISDICTION

The final decree of the Circuit Court of Appeals affirming the decision of the Board of Tax Appeals

was entered April 12, 1940 (R. 29). Petition for a writ of certiorari was filed June 20, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the amount of taxes paid by the taxpayer in 1934 to the Canadian Government upon income earned in the years 1930 to 1933, inclusive, may be allowed as a credit against taxpayer's 1934 federal income tax, reported on the accrual basis.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 31. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.
>
> The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax, to the extent provided in section 131.
>
> SEC. 41. GENERAL RULE.
>
> The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such

method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (For use of inventories, see section 22 (c).)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. In the case of the death of a taxpayer there shall be allowed as deductions and credits for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly allowable in respect of such period or a prior period.

SEC. 131. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

(a) *Allowance of Credit.*—If the taxpayer signifies in his return his desire to have the benefits of this section, the tax imposed by this title shall be credited with:

(1) *Citizen and Domestic Corporation.*—In the case of a citizen of the United States

and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

* * * * *

(d) *Year in Which Credit Taken.*—The credits provided for in this section may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping his books, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued, subject, however, to the conditions prescribed in subsection (c) of this section. If the taxpayer elects to take such credits in the year in which the taxes of the foreign country or the possession of the United States accrued, the credits for all subsequent years shall be taken upon the same basis, and no portion of any such taxes shall be allowed as a deduction in the same or any succeeding year.

(e) *Proof of Credits.*—The credits provided in this section shall be allowed only if the taxpayer establishes to the satisfaction of the Commissioner (1) the total amount of income derived from sources without the United States, determined as provided in section 119, (2) the amount of income derived from each country, the tax paid or accrued to which is claimed as a credit under this section, such amount to be determined under rules and regulations

prescribed by the Commissioner with the approval of the Secretary, and (3) all other information necessary for the verification and computation of such credits.

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 41–1. *Computation of net income.*— Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditures which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See articles 42–1 to 42–3.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

ART. 131–6. *When credit for taxes may be taken.*—The credit for taxes provided by section 131 (a) may ordinarily be taken either in the return for the year in which the taxes accrued or in which the taxes were paid, dependent upon whether the accounts of the taxpayer are kept and his returns filed upon the accrual basis or upon the cash receipts and disbursements basis. Section 131 (d) allows the taxpayer, at his option and irrespective of the method of accounting employed in keeping his books, to take such credit for taxes as may be allowable in the return for the year in which the taxes accrued. An election thus made under this section or under section 222 (c) or 238 (c) of the Revenue Act of 1924 or 1926, or under section 131 (d) of the Revenue Act of 1928 or 1932, must be followed in returns for all subsequent years, and no portion of any such taxes will be allowed as a deduction from gross income for 1934 or any subsequent taxable year.

STATEMENT

The evidentiary facts will be found in the opinion of the Board of Tax Appeals (R. 12–18), which sets out in full the stipulation of facts (R. 10–11). The testimony of the single witness produced by the taxpayer is summarized in a statement prepared as part of the record on appeal (R. 24–25).

The taxpayer, an Ohio corporation, had done business in Canada through an agent for more

than fifteen years prior to 1937 (R. 12). In 1924 an income tax law went into effect in Canada, but the taxpayer's Canadian representative advised taxpayer that it was not subject thereto. Accordingly, the taxpayer filed no returns with the Canadian Government (R. 13).

In August 1933, the Canadian Government asked the taxpayer to file returns for the years 1930 to 1933, inclusive. This the taxpayer did in September and November 1933, and June 1934 (R. 13). The taxpayer contested the imposition of Canadian income tax on the theory that it was not doing business in Canada within the purview of the Canadian law. Taxpayer was not convinced that it was amenable to the Canadian income tax law until June 25, 1934, at which time it paid $9,722.33, representing taxes, penalties, and interest due the Canadian Government for the years 1930, 1931, and 1932. In November 1934, taxpayer paid $1,125.97, representing taxes, penalty, and interest due the Canadian Government for the year 1933 (R. 13).

The income tax returns filed by the taxpayer have all contained the statement that they were made upon the accrual basis and not upon the cash receipts and disbursements basis (R. 13). Taxpayer consistently throughout its corporate existence has shown gross income from sales as received when the sales were made, whether or not cash was collected at the time. Inventories of goods on

hand are used at the beginning and end of each year in determining the cost of goods sold. The expenses of the taxpayer have been consistently recorded only after cash was disbursed and the taxpayer has never accrued on its books any federal, state, county, municipal, or other taxes. But the Commissioner in adjusting the taxpayer's returns has accrued these taxes (R. 13–14). The taxpayer always paid its bills currently (R. 14–15).

The Board found that the accounting system employed by the taxpayer was predominantly an accrual system (R. 17), and that the Commissioner consistently corrected the returns of the taxpayer where mistakes resulted because of the deduction of taxes on the cash basis (R. 16–17). Consequently, the Board found that the taxpayer could not take a credit for Canadian income taxes in the year when they were paid as distinguished from the years when they accrued. The Board also found that the Canadian income taxes paid in 1934 had all accrued prior to that year and the credits sought by the taxpayer were disallowed (R. 18). The Circuit Court of Appeals affirmed the Board's decision.

ARGUMENT

Taxpayer's position below was primarily that it employed a hybrid system of accounting, involving inventories and accrual of income items but recording expenditures as made. It urged that the system correctly reflected taxable income, and ac-

cordingly that taking credit for the Canadian taxes in the year of payment, rather than that of accrual, was proper (R. 3, 21–22). The Board of Tax Appeals found that the taxpayer's bookkeeping system was predominantly an accrual one and that the Commissioner correctly refused to permit a departure from that system through credit for Canadian taxes in a year other than that of their accrual. The Circuit Court of Appeals correctly affirmed. *Niles Bement Pond Co.* v. *United States,* 281 U. S. 357; *Mass. Mutual Life Ins. Co.* v. *United States,* 288 U. S. 269, 273–274.

The taxpayer does not assert any conflict among the circuit courts of appeals, but alleges simply a conflict with *Connor* v. *United States,* 19 F. Supp. 97 (N. H.). There, as in the instant case, the taxpayer became convinced of his liability for Canadian income tax in a year subsequent to that for which it was levied. But, unlike the taxpayer here, Connor did not attempt to accrue the credit in the year of payment. Instead, he filed an amended federal tax return seeking the credit in the year for which the Canadian tax was levied. By reason of Section 131 (d) of the Revenue Act of 1934, *supra,* Connor, who was on the cash basis, could elect to take the credit on the accrual basis. The court was concerned with whether his failure to show the credit in the original return constituted an election not to accrue the credit. The portion of the opinion quoted by the taxpayer here (Br. 9) was ad-

dressed to that issue. But Section 131 (d) does not alter the basic rule of Section 43, *supra,* that a taxpayer on the accrual basis must take the credit for foreign taxes in the year of their accrual.

Section 131 (d) permits a taxpayer on the cash basis to accrue his credits for foreign taxes, but it does not allow the converse. A taxpayer on the accrual basis is not given any election to use the credit when the foreign taxes are actually paid: being on the accrual basis, he may employ that credit only when the foreign taxes accrue. The taxpayer here was on the accrual basis, and consequently could not take the credit for pre-1934 Canadian taxes in 1934.

CONCLUSION

The decision of the Circuit Court of Appeals in the instant case is correct and is not in conflict with any other decision. It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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